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No. 87-330

In The

Supreme Court of the United States

October Term, 1987

JOHN MARTIN-MUSUMECI,

Petitioner,

vs.

RODERICK L. CRAMER, *et al.*,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF CALIFORNIA FIRST APPELLATE DISTRICT

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November 10, 1987

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LIST OF PARTIES

This petition relates to six separate but identical proceedings in which petitioner was the appellant before the court below. Each respondent named herein was a respondent in one of those six proceedings. The parties to the proceedings below were the petitioner herein, John Martin-Musumeci, and respondents herein were as follows: Roderick L. Cramer, Bona Dee Cramer, Beriyth Corporation (Appeal No. A034241); Microsource, Inc., Kelly Bryan, Martha Bryan, Joseph Knesz, Alma Knesz (Appeal No. A034243); J.D. Wessling, Caroline Wessling, Wesscomp, Inc. (Appeal No. A034498); Gordon C. Johnson, Allen S. Peterson, Western Compuware, Inc. (Appeal No. A034499); William E. Hart, Jimmy H. Dunne, Hart's Inc. (Appeal No. A034502); Softcomp, Inc., Pat Connolly, Tom Tjerian (Appeal No. A034503).

All parties to the proceedings below are before this Court.

TABLE OF CONTENTS

Page

LIST OF PARTIES i

TABLE OF AUTHORITIES iii

STATEMENT OF THE CASE 1

REASONS FOR DENYING THE PETITION 3

I. THE CALIFORNIA COURT OF APPEAL DECISION WOULD NOT CATEGORICALLY DENY THE BENEFITS OF THE FEDERAL ARBITRATION ACT TO EMPLOYEES OF PARTIES TO ARBITRATION AGREEMENTS 4

a) There is no Conflict with Federal Precedent in Holding that no Contract to Arbitrate was Made Between Petitioner and Respondents;

b) Where no Contract Between the Parties was Formed, no Public Policy Favoring Arbitration is Violated by Refusing to Compel Parties to Arbitrate; and,

c) The California Court's Decision Does Not Nullify the Federal Arbitration Act as to Claims Brought Against Employees In State Court 4

II. THE ISSUE AS TO THE SCOPE OF THE ARBITRATION PROVISIONS NEED NOT BE REACHED WHERE THE COURT HAS DETERMINED THAT PETITIONER WAS NOT A PARTY TO ANY ARBITRATION AGREEMENT 9

III. THE COURT OF APPEAL DID NOT RELY ON THE UNIQUENESS OF THE ARBITRATION AGREEMENT NOR CARVE OUT AN EXCEPTION FOR ARBITRATION AGREEMENTS IN RENDERING ITS DECISION 10

APPENDIX 1A

TABLE OF AUTHORITIES

Page(s)

CASES

Barrowclough v. Kidder, Peabody & Co., 752 F.2d 923 (3d Cir. 1985) 5

Davis v. Chevy Chase Financial Ltd., 667 F.2d 160 (D.C. Cir. 1981) 8

Freeman v. State Farm Mutual Automobile Insurance Co., 14 Cal.3d 473 (1975) 8

Hartford Financial Systems v. Florida Software Services, Inc., 550 F.Supp. 1079 (D.Maine 1982) 6

Genesco, Inc. v. T. Kakiuchi & Co., 815 F.2d 840 (2d Cir. 1987) 8, 9

Letizia v. Prudential Bache Securities, Inc., 802 F.2d 1185, 1187-88 (9th Cir. 1986) 5

Merrill Lynch, Pierce Fenner & Smith, Inc. v. Hovey, 726 F.2d 1286, 1288-89 (8th Cir. 1984) 5

Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985) 7

Moruzzi v. Dynamics Corp. of America, 443 F. Supp. 332 (S.D.N.Y. 1977) 8

Moses H. Cone Hospital v. Mercury Construction Corp., 460 U.S. 1 (1982) 7

Oriental Commercial and Shipping v. Rossell N.Y., 609 F.Supp. 75 (D.C.N.Y. 1985) 6

Perry v. Thomas, 107 S.Ct. 2520, 96 L.Ed. 2d 426, 55 U.S.L.W. 4832, 4835 (U.S. June 15, 1987) 8

Seaboard Coast Line Railroad Co. v. Trailer Train Co., 690 F.2d 1343 (11th Cir. 1982) 8

Southland Corp. v. Keating, 465 U.S. 1 (1984) 7

United Steelworkers of America v. Warrior & Gulf Navigation Co., 363 U.S. 574 (1960) 8

TABLE OF AUTHORITIES—Continued

Page(s)

Weeks v. Crow, 113 Cal.App.3d 350 (1980) 8

Wren Distributors, Inc. v. Phone-Mate, Inc., 600 F.Supp. 1576 (E.D.N.Y. 1985) 6

STATUTES

Cal. Civ. Proc. Code § 1281.2 (Deering 1981) 6

Cal. Civ. Code § 1636 (Deering 1971) 6

Cal. Civ. Code § 1654 (Deering 1971) 6

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RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF CALIFORNIA FIRST APPELLATE DISTRICT

STATEMENT OF THE CASE

Respondents herein are groups of individuals solicited by promoter John Martin-Musumeci to purchase franchises of what was purported to be a nationwide consumer software distribution network, Softsmith Corporation (hereinafter "Softsmith").

During the course of promoting this enterprise, petitioner made numerous misrepresentations to respondents,

including, principally, the extent of his personal wealth and financial stability and his ability, willingness, and commitment to contribute his personal wealth to ensure the success of Softsmith. In connection with his promotion, petitioner further misrepresented the financial condition and stability of Softsmith, its projected operations, performance, and profitability.

As a direct result of their reliance on petitioner's misrepresentations, respondents each executed a lengthy franchise agreement with Softsmith. They did so believing that Softsmith was personally backed by petitioner and was therefore capable of weathering anticipated fluctuations in the relatively new consumer software market. Softsmith was, in fact, severely undercapitalized and almost immediately began to encounter financial difficulties. Petitioner was unwilling or unable to lend his financial support to Softsmith and it suffered a swift and complete failure. As a direct result of Petitioner's misrepresentations, respondents paid and lost substantial sums in franchise fees and monies advanced for inventory.

The arbitration clause petitioner wishes to enforce is part of the agreement entered into between respondents and Softsmith. It has been reviewed and consistently interpreted by the California courts not to include petitioner as a party.

The trial court reviewing the agreement determined that under both federal and California law petitioner was not a party, and not intended to be a party, to the agreement, and that neither petitioner nor respondent could compel arbitration between them under its terms. (Statement of Decision, Petition for Writ of Certiorari, pp. 16A-19A.)

The court of appeal affirmed the trial court's decision holding that the mutual intention of the parties was not to include petitioner as a party to the agreement (Opinion, Pet., p. 5A.) The court found that any actions arising in this litigation did not involve petitioner's acts as an agent or employee of Softsmith. (Opinion, Pet., pp. 5A-6A.)

The court further found that the alleged acts and misrepresentations occurred prior to the execution of the agreement during which time petitioner was allegedly engaged in a fraudulent scheme on his own behalf and for his own profit (*Id.*)

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REASONS FOR DENYING THE PETITION

There is no good reason for this Court to disturb the ruling of the lower courts.

The court of appeal decison would not categorically deny the benefit of the Federal Arbitration Act to employees of parties to an arbitration agreement.

First, the ruling below was based on a finding by the trial court, using well-established state contract law principles, that respondents and Softsmith did not intend to include petitioner as a party to the agreement. Absent the requisite intent, there is no agreement between petitioner and respondents. Respondents therefore cannot be compelled to arbitrate their claims against petitioner.

The California court's application of state contract law principles in deciding whether an agreement was

reached between the parties is fully supported by federal precedent.

Second, there is no policy favoring the extension of an arbitration agreement to persons who have not agreed to submit disputes between themselves to arbitration. Neither is there policy favoring the extension of an arbitration agreement to persons who were not intended to be parties to the agreement.

Finally, any concern that the court of appeal decision would nullify the Federal Arbitration Act as to claims brought against employees in state court is unfounded. Employees who demonstrate that they are either parties to an agreement or intended to be parties to an agreement whose arbitration clause they seek to invoke are not denied the benefits of the Federal Arbitration Act.

I.

THE CALIFORNIA COURT OF APPEAL DECISION WOULD NOT CATEGORICALLY DENY THE BENEFITS OF THE FEDERAL ARBITRATION ACT TO EMPLOYEES OF PARTIES TO ARBITRATION AGREEMENTS

a) There is no conflict with Federal precedent in holding that no contract to arbitrate was made between petitioner and respondents.

b) Where no contract between the parties was formed, no public policy favoring arbitration is violated by refusing to compel parties to arbitrate.

c) The California court's decision does not nullify the Federal Arbitration Act as to claims brought against employees in state court.

Petitioner argues that the court of appeal decision would categorically deny the benefit of the Federal Ar-

bitration Act to employees of parties to arbitration agreements. Petitioner bases this argument on the following premise: "The court of appeal held, as a matter of state law, that a non-party employee may not enforce an arbitration agreement." (Pet., p. 6.) This premise is incorrect. The court of appeal held that where a non-signatory employee was not intended by the parties to the arbitration agreement to be a party to that agreement, the employee could not compel arbitration. (Opinion, Pet., pp. 5A-6A.) In doing so, the state court did not deny the benefit of the Federal Arbitration Act to either signatory employees or non-signatory employees who were intended by the parties of the arbitration agreement to be included.

Correctly read, the California appeal court decision is not in conflict with the cases cited by petitioner at pages six and seven of his brief. In each of those cases, all involving stock brokerages, the court determined that the party opposing arbitration was either a party to an arbitration agreement or intended to be covered by the arbitration agreement.[1]

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[1] In *Letizia v. Prudential Bache Securities, Inc.*, 802 F.2d 1185, 1188 (9th Cir. 1986) the court noted that all of the alleged wrongful acts by the non-signatory employees related to their handling of plaintiff's securities account and that the signatory broker had clearly indicated its intention to protect its employees through the customer agreement.

In *Barrowclough v. Kidder, Peabody & Co.*, 752 F.2d 923, 937 (3d Cir. 1985) the court found Barrowclough to be a party to the agreement compelling arbitration.

In *Merrill Lynch, Pierce Fenner & Smith, Inc. v. Hovey*, 726 F.2d 1286, 1288-89 (8th Cir. 1984) the court found that three

(Continued on following page)

The issue of whether a party is bound to an arbitration agreement is determined by reference to state contract law principles. *Wren Distributors, Inc. v. Phone-Mate, Inc.*, 600 F.Supp. 1576 (E.D.N.Y. 1985).[2] Accordingly, the California courts have acted in consonance with federal precedent by applying state contract law principles which hold that absent an ascertainable agreement to arbitrate, one cannot be compelled to arbitrate.[3] Applying these principles, the lower courts found that petitioner was not a party to the agreement and not intended to be a party to the agreement.

The facts support this finding. The subject franchise agreement is a sophisticated ninety-one page document detailing virtually every aspect and contingency of the relationship between respondents and Softsmith. It has never been disputed that petitioner caused the agreement to be drafted yet the agreement never mentions petitioner by name or reference. Neither the agreement nor its arbitration clause specifically or generally references officers, directors or employees of Softsmith as parties to any

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(Continued from previous page)

employees were entitled to arbitration under exchange rules governing disputes arising out of the employment relationship while two employees who were not members of the stock exchange were entitled to arbitration under a provision of the exchange constitution which allowed non-members to compel arbitration.

[2] *Hartford Financial Systems v. Florida Software Services, Inc.*, 550 F.Supp. 1079, 1086-87 (D.Maine 1982); *Oriental Commercial and Shipping Co., Ltd. v. Rosseel*, 609 F.Supp. 75, 78 (S.D.N.Y. 1985).

[3] Cal. Civ. Proc. Code § 1281.2 (Deering 1981), reprinted in the Appendix hereto, pp. 1A-2A; Cal. Civ. Code § 1636, et seq. (Deering 1971), pp. 2A-3A, infra; Cal. Civ. Code § 1654 (Deering 1971), p. 4A, infra.

arbitration. The agreement anticipates future litigation in such areas as restraint of trade and securities violations. Such a sophisticated, lengthy document cannot be said to inferentially include petitioner as a party to the agreement. Had the parties intended to include petitioner within the agreement, it would have been a simple matter to do so.

Petitioner asserts " . . . this Court, and the courts of appeal for several circuits, have expressly held that the arbitrability of a particular dispute is determined according to federal substantive law." (Pet., p. 7.) The cases cited by petitioner for this proposition are clearly distinguishable. In each of those cases there was no issue as to whether a party to the litigation was a party, or intended to be a party, to the arbitration agreement. Instead, the courts in those cases addressed the scope of issues covered by an agreement between the parties.[4]

Respondents concede that the Federal Arbitration Act expresses a strong federal policy favoring enforcement of arbitration agreements, and prohibits states from denying arbitration of a dispute which is within the scope

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[4] E.g., in *Moses H. Cone Hospital v. Mercury Construction Corp.*, 460 U.S. 1 (1982) this Court addressed the exceptional-circumstances argument in the context of a construction agreement between the parties.

In *Southland Corp. v. Keating*, 465 U.S. 1 (1984) this Court addressed the supremacy clause in light of the conflict between the Federal Arbitration Act and the California Franchise Investment Law in the context of a franchise agreement between the parties.

In *Mitsubishi Motors v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985), this Court addressed the issue as to whether anti-trust claims were encompassed within the scope of a sales agreement between the parties containing an arbitration provision.

of such an agreement. Policy considerations, however, do not come into play absent a preliminary finding of an agreement between the parties. A court must first determine whether the parties agreed to arbitrate. Only thereafter must a court determine the scope of the agreement. *Genesco, Inc. v. T. Kakiuchi & Co., Ltd.*, 815 F.2d 840, 844 (2d Cir. 1987).

This Court has held that an "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed to submit" *United Steelworkers of America v. Warrior & Gulf Navigation Co.*, 363 U.S. 574, 582 (1960). The Federal Arbitration Act does not preclude parties from contractually limiting the scope of their arbitration agreement.[5] Arbitration, however favored by the courts and the Congress, is a contractual right. It may not be invoked by one who is not a party to the agreement and does not otherwise possess the right to compel arbitration. *Moruzzi v. Dynamics Corporation of America*, 443 F.Supp. 332, 334 (S.D.N.Y. 1977).[6] Federal policy cannot serve to stretch a contract beyond the scope intended by its parties. *Seaboard Coast Line Railroad Co. v. Trailer Train Co.*, 690 F.2d 1343, 1352 (11th Cir. 1982).

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[5] *Seaboard Coast Line Railroad Co. v. Trailer Train Co.*, 690 F.2d 1343, 1348, 1352 (11th Cir. 1982); *Davis v. Chevy Chase Financial Ltd.*, 667 F.2d 160, 165 (D.C. Cir. 1981); See also *Perry v. Thomas*, 107 S.Ct. 2520, 96 L.Ed.2d 426, 55 U.S.L.W. 4832, 4835 (U.S. June 15, 1987), fn. 9 wherein this Court, in dicta, references the application of state law to determine the validity, revocability, and enforceability of contracts generally and the application of federal law to issues unique to arbitration agreements, e.g., unconscionability.

[6] California law is consistent in this regard. *Freeman v. State Farm Mutual Automobile Insurance Co.*, 14 Cal.3d 473, 479 (1975); *Weeks v. Crow*, 113 Cal.App.3d 350, 352-3 (1980).

Petitioner asserts the "court of appeal's decision would fortuitously deny enforcement of an arbitration agreement in those cases where an employee of a party to the agreement is available to be sued in state court, even though the dispute is plainly within the scope of the arbitration agreement." (Pet., p. 8.) This unsupported assertion is incorrect. Correctly and fairly read, the decision would have no adverse effect on an employee's right to benefits under the Federal Arbitration Act where the employee is a party to an arbitration agreement or where the parties to the agreement intended for the employee to be a party thereto. On the other hand, petitioner's argument, if applied as petitioner urges, would mandate that non-signatory employees be permitted to compel arbitration in every case, regardless of the intent of the parties to the arbitration agreement. This application is unsupported by legal precedent.

II.

THE ISSUE AS TO THE SCOPE OF THE ARBITRATION PROVISIONS NEED NOT BE REACHED WHERE THE COURT HAS DETERMINED THAT PETITIONER WAS NOT A PARTY TO ANY ARBITRATION AGREEMENT

The Court of Appeal upheld the finding of the trial court that petitioner was not a party to the agreement and not intended to be a party to the agreement. This threshold issue having been resolved against petitioner, it is not necessary to determine the scope of the agreement.[7] In focusing his arguments on the scope of the is-

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[7] *Genesco, Inc. v. T. Kakiuchi & Co.*, 815 F.2d 840 (2d Cir. 1987).

sues to be arbitrated under the terms of the agreement and ignoring the findings by the lower courts, petitioner obfuscates the holding below and attempts to create an issue on appeal where none exists.

Petitioner states that the court of appeal resolved the issue, " . . . on the superficial, simplistic basis that petitioner was not expressly named in the Agreements." (Pet., p. 9.) Such a reading of the opinion is itself superficial and simplistic. The court of appeal affirmed and articulated the trial court's analysis of the numerous factors governing the interpretation of the agreement under contract principles, including the intention of the parties. (Opinion, Pet. pp. 4A-5A.) The opinion cannot be fairly read as limited to whether petitioner was or was not expressly named in the agreement.

III.

THE COURT OF APPEAL DID NOT RELY ON THE UNIQUENESS OF THE ARBITRATION AGREEMENT NOR CARVE OUT AN EXCEPTION FOR ARBITRATION AGREEMENTS IN RENDERING ITS DECISION

Although the court of appeal references California constitutional guarantees of the right to a jury trial, the court does not base its holding specifically on that ground. Its decision can be and is supported on more general grounds, i.e., that petitioner was not a party to the agreement. Specifically, the court observed its duty to examine the intent of the parties " . . . in light of the usual and ordinary meaning of contractual language and circumstances under which the agreement was made." (Opinion, Pet., p. 4A.) The court of appeal specifically noted:

> In Civil Code section 1635 et seq. the Legislature has presented rules for the interpretation of contracts. A comprehensive analysis of those rules is contained in 1 Witkin, *Summary of Cal. Law*, (8th ed. 1973) Contracts §§ 520 et seq. In general, contracts must be interpreted to give effect to the mutual intention of the parties, if such is ascertainable. (Civ. Code § 1636.) The intention of the parties to written agreements is to be determined, if possible, from the language of the agreement itself. (Civ. Code, §§ 1638, 1639.) The words of a contract are to be understood in their "ordinary and popular sense, rather than according to their strict legal meaning," unless the parties indicate otherwise. Civ. Code, § 1644.)
>
> The agreements in question are between Softsmith Corporation, a California corporation and the various respondents. They cannot reasonably be interpreted to include or define appellant as a party thereto. The arbitration portion of the agreements refers and applies only to the parties. It provides that certain claims, "*excepting as described below*" are subject to arbitration. Claims involving consequential or punitive damages are specifically not subject to the arbitrator's "authority to award." The agreement does not contain a waiver of punitive or consequential damages, nor a liquidated damages clause. (Opinion, Pet., pp. 4A-5A.) (Emphasis in original)

This language and similar language throughout the opinion clearly evidences that the Court of Appeal did not rely on uniqueness of the arbitration agreement nor carve out an exception for arbitration agreements. It simply applied general contract principles.

Contrary to petitioner's assertion, no special obstacles to enforcement of an arbitration agreement are created by the court's holding. The threshold question at

the appellate level, as at every lower court level, has been a determination, applying general contract principles, of whether the parties herein actually entered into an agreement to arbitrate. The Court having found that petitioner was not a party to the franchise agreement and having found no intent by respondents and Softsmith to include petitioner as a party to the agreement, there is simply no agreement to arbitrate which petitioner is entitled to compel.

The California courts have analyzed the entirety of the franchise agreement, applied it to the facts of the underlying dispute, and in accordance with state and federal law have determined the threshold question adverse to petitioner. The petition should be denied.

Respectfully submitted,

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Dated: November 10, 1987

(Appendix follows)

APPENDIX

California Code of Civil Procedure § 1281.2.

On petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall order the petitioner and the respondent to arbitrate the controversy if it determines that an agreement to arbitrate the controversy exists, unless it determines that:

(a) The right to compel arbitration has been waived by the petitioner; or

(b) Grounds exist for the revocation of the agreement.

(c) A party to the arbitration agreement is also a party to a pending court action or special proceeding with a third party, arising out of the same transaction or series of related transactions and there is a possibility of conflicting rulings on a common issue of law or fact. For purposes of this section, a pending court action or special proceeding includes an action or proceeding initiated by the party refusing to arbitrate after the petition to compel arbitration has been filed, but on or before the date of the hearing on the petition. This subdivision shall not be applicable to an agreement to arbitrate disputes as to the professional negligence of a health care provider made pursuant to Section 1295.

If the court determines that a written agreement to arbitrate a controversy exists, an order to arbitrate such controversy may not be refused on the ground that the petitioner's contentions lack substantive merit.

If the court determines that there are other issues between the petitioner and the respondent which are not subject to arbitration and which are the subject of a pending action or special proceeding between the petitioner and the respondent and that a determination of such issues may make the arbitration unnecessary, the court may de-

lay its order to arbitrate until the determination of such other issues or until such earlier time as the court specifies.

If the court determines that a party to the arbitration is also a party to litigation in a pending court action or special proceeding with a third party a sset forth under subdivision (c) herein, the court (1) may refuse to enforce the arbitration agreement and may order intervention or joinder of all parties in a single action or special proceeding; (2) may order intervention or joinder as to all or only certain issues; (3) may order arbitration among the parties who have agreed to arbitration and stay the pending court action or special proceeding pending the outcome of the arbitration proceeding; or (4) may stay arbitration pending the outcome of the court action or special proceeding.

California Civil Code § 1636.

A contract must be so interpreted as to give effect to the mutual intention of the parties as it existed at the time of contracting, so far as the same is ascertainable and lawful.

California Civil Code § 1637.

For the purpose of ascertaining the intention of the parties to a contract, if otherwise doubtful, the rules given in this chapter are to be applied.

California Civil Code § 1638.

The language of a contract is to govern its interpretation, if the language is clear and explicit, and does not involve an absurdity.

California Civil Code § 1639.

When a contract is reuced to writing, the intention of the parties is to be ascertained from the writing alone, if possible; subject, however, to the other provisions of this title.

California Civil Code § 1640.

When, through fraud, mistake, or accident, a written contract fails to express the real intention of the parties, such intention is to be regarded, and the erroneous parts of the writing disregarded.

California Civil Code § 1641.

The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other.

California Civil Code § 1644.

The words of a contract are to be understood in their ordinary and popular sense, rather than according to their strict legal meaning; unless used by the parties in a technical sense, or unless a special meaning is given to them by usage, in which case the latter must be followed.

California Civil Code § 1646.

A contract is to be interpreted according to the law and usage of the place where it is to be performed; or, if it does not indicate a place of performance, according to the law and usage of the place where it is made.

California Civil Code § 1647.

A contract may be explained by reference to the circumstances under which it was made, and the matter to which it relates.

California Civil Code § 1648.

However broad may be the terms of a contract, it extends only to those things concerning which it appears that the parties intended to contract.

California Civil Code § 1654.

In cases of uncertainty not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist.